Microfinance Against Poverty : The Nepalese Scenario

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Microfinance institutions, both formal and informal, provide financial services which help in creating self-employment and income opportunities among the poor. NRB has made a number of innovative attempts for developing microfinance framework in the country. The article attempts to analyze the extent of the access provided, and the generation of employment opportunities, by the formal and semi-formal microfinance institutions/ programs in addition to identifying the problems faced in attaining financial sustainability by them. In view of the increasing need for microfinance services in terms of both the amount and coverage, NRB needs to enhance its capabilities to regulate, supervise and monitor large number of MFIs and also come up with innovative and suitable credit policies/regulations that would create an enabling environment for MFIs to grow and attain sound financial health. Some of the desired roles for HMG are demonstrating firm commitment towards poverty alleviation through action, stopping direct involvement in running and managing MFIs, stopping owning MFIs, and handing over presently owned shares of such institutions to the private sector through appropriate and transparent mechanism.

1. POVERTY PROFILE

The population below the poverty line in Nepal increased from 41.5 percent in 1984/85, last year of the Sixth Plan Period (1980/81–1984/85), to 49.0 percent in 1991/92. Realizing the need to address the ever-increasing poverty problem, the government aimed to increase the economic growth at a faster rate, reducing poverty and regional imbalances in its Eighth Plan. The government further intensified the financial reform process through the implementation of Enhanced Structural Adjustment Program (1992/93 – 1994/95) that had the objectives of promoting competition in the financial system, enhancing domestic savings, fostering efficient allocation of financial resources, and increasing flow of financial resources in the priority sector. Nepal Living Standards Survey conducted by CBS in 1996, fourth year of the Eighth Plan Period, revealed the population below

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poverty line being reduced to 42 percent. Having achieved some success in poverty reduction front during the Eighth Plan, the government implemented the Ninth Plan (1997/98–2001/02) with the sole objective of poverty reduction and fixed the target of increasing economic growth rate at 6.0 percent per year, and reducing the percentage of population below poverty line from 42.0 percent to 32.0 percent. The Plan had adopted the concept of reducing poverty through higher growth rate in agricultural sector and creating employment opportunities by deploying increased investments in water resources, tourism and industrial sectors, and had implemented policies and programs accordingly. Estimates based on the performance of the first three years of the Ninth Plan period indicated further reduction in the population below poverty line to 38 percent [NPC 2001]. The sources of some studies/surveys and their estimates of the poverty line and the proportion of population below such line in the past are presented in the following table:

Table 1. Population Below the Poverty Line

Source	Population below the poverty line (%)
1. National Household Survey of Income/Consumption Conducted in 1977, NPC	**36.0**
2. Multipurpose Household Budget Survey conducted in 1984/85, NRB	**41.5**
3. Estimates Made Prior to the Implementation of the Eighth Five Year Plan (1992/93 – 1996/97), HMG	**49.0**
4. Nepal Living Standards Survey conducted in 1996, CBS	**42.0**
5. Estimates Based on the Performance of the First Three Years of the Ninth Plan, NPC's Concept Paper on the Tenth Plan, February 2003	**38.0**

The Tenth Plan (2002/03 – 2006/07), which is currently under implementation, stipulates again the sole objective of poverty alleviation. The Plan has fixed the target of reducing the population below the poverty line from 38 percent to 30 percent [NPC 2001]. To achieve the Tenth Plan's objective of "poverty alleviation", a firm commitment from the government and the political parties is essential and all the efforts should clearly be geared towards increasing the outreach of the formal and semi-formal financial institutions engaged in microfinance services.

2. ROLE OF MICROFINANCE

"Microfinance", as defined by ADB's Microfinance Development Strategy [ADB 2000], is the financial service such as deposits, loans, payment services, money transfers, and insurance to poor and low income households and their microenterprises. Studies in Nepal and elsewhere [Rahman and Khandker 1994] have clearly indicated microfinance as a powerful tool for alleviating poverty.

MFIs in Nepal are serving primarily the microentrepreneurs who operate or are starting to operate very small enterprises, termed as microenterprises. Accesses of microentrepreneurs to microfinance services provide them with an important tool for improving their efficiency, productivity, and welfare while reducing risk. In other words, MFIs, both formal and informal, provide financial services which help in creating job opportunities to the microentrepreneurs, both wage and self-employment, and thereby generating income among the poor.

The informal financial markets in Nepal have been in existence for generations, whereas the first initiation of formal sector lending in rural Nepal began in 1956 with the establishment of credit cooperatives in the Rapti Valley of Chitwan district [Sharma and Nepal, 1997]. The Nepal Rural Credit Review Report [NRB 1994] revealed that, in 1991/92, only 39 percent of the rural households had borrowed, of which 86.82 percent[+] had borrowed from informal sources such as landlords, merchants/traders and friends and relatives, and 20.29 percent[+] from formal sources such as banks and financial institutions. Hence, in 1991/92, a year before the beginning of the Eighth Plan Period (1992/93 – 1996/97), the coverage of the formal financial sources was one-fifth and that of the informal sources was four-fifths. These findings clearly indicate dominance of informal sources in rural financial market in terms of outreach. This calls for an increased coverage of formal and semi-formal MFIs/Ps for poverty alleviation.

3. *FINANCIAL MARKET*

The prominent participants/actors in the Nepalese financial market can be categorized into three sectors: *Formal, Semi-Formal, and Informal*. The type of participants and their numbers by sector, as of mid January 2003 are as follows:

Formal Sector

- Commercial Banks [17]
- Development Banks including ADB/N and NIDC [10]
- Rural Microfinance Development Banks [11]
- Finance Companies (FCs) [55]

[+] Sum of these two figures exceeds 100, because 7.11 percent households had borrowed from both the sources.

Semi-Formal Sector

- Savings and Credit Cooperatives (SCCs) [2,262 SCCs were registered by mid-July 2002, of which 34 had been licensed by NRB for limited banking activities, 391 were the members of Nepal Federation of Savings and Credit Cooperative Union (NEFSCUN), 107 were graduated as SFCLs under SFDP, and 82 were promoted under MCPW].
- Financial Intermediary Non-Governmental Organizations (FI-NGOs) [37 licensed by NRB under the Financial Intermediary Societies Act, 1998].

Informal Sector

- Savings and Credit Organizations (SCOs) [>12,000]
- Self-help Groups [Several]
- Landlords, Merchants/Traders, Goldsmiths, Friends and relatives [Several]

4. DEVELOPMENT OF MFIS

Rural Microfinance Development Banks

Two regional level rural microfinance development banks (also known as Grameen Bikas Banks), one each in the Eastern and the Far-Western Development Regions, were established towards the end of 1992. By June 1996, other three such banks, one each in the other three Development Regions, were also set up. These Grameen Bikas Banks represent an innovative outreach model patterned on the Grameen Bank of Bangladesh, which caters the financial needs of the deprived sections of the society in rural areas. HMG and NRB own majority shares of these banks. Later on, the private sector promoters set up Nirdhan Utthan Bank in 1998 and the Shwabalamban Bikas Bank in 2001, both of which are also grameen bank replicators. Deprosc Bikas Bank and the Chhimek Bikas Bank, established in 2000 and 2001 respectively, are also poverty focused microfinance banks, but don't follow the grameen bank pattern. However, all these nine MFIs provide *retail-banking services* to the deprived sections without physical collateral. With a view to provide wholesale loans and also strengthen the capabilities of the rural MFIs, the "Rural Microfinance Development Centre" was set up in 1998 under Asian Development Bank's initiatives and the Sana Kisan Bikas Bank in 2001 under GTZ's initiatives. Both are *second tier* institutions. The former provides wholesale loans to microfinance institutions, such as poverty focused development banks, SCCs and FI-NGOs, whereas the latter extends such loans mainly to the member SCCs. By January 2003, a total of 11 rural microfinance banks were in operation and all of them were licensed under the Development Bank Act, 1996.

Savings and Credit Cooperatives

Cooperative Act, 1992 was enacted in 1992. It provided legal framework for the cooperatives to function as people-based institutions. No Savings and Credit Cooperatives were established till 1993/94. It was only in 1994/95 that a total of 228 SCCs were registered. The number increased to 343 in mid-July 1996, 1,271 in mid-July 1999 and 2,262 in mid-July 2002. Of a total of 2,262 SCCs in mid-July 2002, 34 had been licensed by NRB under the Cooperative Act, 1992 to undertake limited banking activities.

Financial Intermediary Non-Governmental Organizations

In Nepal, Society Registration Act, 1978 allows non-profit welfare organization to register as an NGO. Enactment of Financial Intermediary Societies Act, 1998 enables such NGOs to provide financial services to the deprived section of the societies under group guarantee basis. However, the NGOs willing to undertake such functions will have to get license from NRB before they start the microfinance activities. Social Welfare council's estimate indicates the existence of 18,000 NGOs operating in the country [Kantipur, April 30,1996]. Of this total, 13 NGOs had taken license from NRB in 2000. The number of such FI-NGOs increased to 17 in 2001, and to 37 by January 2003. *The Financial Intermediary Societies Act, 1998 has made it obligatory on the part of FI-NGOs to provide financial services only to the people below the poverty line, that too under the group guarantee system*

5. DEVELOPMENT OF MFIS / PROGRAMS

The earliest initiatives for establishing microfinance services in Nepal could be traced to 1956 when the first 13 credit cooperatives were established in the Rapti Valley of Chitwan district under an executive order of the government and with the support of USAID/Nepal. The objective of such cooperatives was to provide credit to the flood-stricken people in the Valley. Before this, the credit needs of the rural sector were met completely by informal sources. In 1974, NRB directed the then two commercial banks to invest at least 5 percent of their total deposits in the "*small sector*". The activities to which credit was to be directed were collectively renamed the *"priority sector*" to cover agriculture, cottage industries, and the service sectors in 1976. At present, CBs are required to lend at least 12 percent (including deprived sector credit) of their total loan portfolio to this sector. *It was through this directive that the CBs were made to participate in rural lending for the first time in Nepal.* In 1990, NRB introduced the "*Deprived Sector Credit Program*" under which CBs are required to lend from 0.25 to 3.00 percent of their total loan portfolio to the hardcore poor. Failure to achieve the target attracted penalty on the shortfall.

A well-structured and specialized project entitled *"Small Farmer Development Project (SFDP)*" to cater the financial needs of the small farmers was initiated as a pilot project in November 1975 by ADB/N. This Project, which covers the entire country, aims at organizing "small farmers" into small credit groups and providing credit on a group guarantee basis. *It was in this project that the concept of group formation and group-based lending as an alternative to the physical collateral was introduced for the first time in Nepal.* A process of institutionalizing the small farmer groups into the *"Small Farmer Cooperative Limited"* has been initiated since 1993/94. The purpose of this initiative is to create locally-owned and managed MFIs that can take over the activities of SFDP on a self-sustaining basis. By mid-January 2003, 125 such SFCLs are in operations in 32 districts. In 1981, NRB introduced the *"Intensive Banking Program (IBP)*" under which the CBs were required to lend a certain percentage of their priority sector loan to the people below the poverty line as group-based lending. Under this lending program, loans are disbursed to the group members on group guarantee and the bank does not ask for any physical collateral. IBP was undertaken by NBL and RBB initially and later by Nabil. The Ministry of Local Development (MLD) in collaboration with UNICEF, NRB, CBs and ADB/N initiated the first women-focused socio-economic program "*Production Credit for Rural Women (PCRW)"* in 1982. This Program involved organization of poor women into small credit groups and appropriate skills training by the MLD staff and extension of group-based loans by the participating banks. This program is in implementation in 55 districts.

MLD initiated yet another project entitled *"Microcredit Project for Women (MCPW)*" in 1994 under ADB financial assistance. It had a provision of involving NGOs as financial intermediaries. The Project was implemented in 12 districts and five municipalities. The Project has promoted 82 CBOs into SCCs and helped 27 NGOs to be FI-NGOs by June 30, 2002. HMG established "*Rural Self-Reliance Fund"* in 1990 and contributed Rs. 10 million through the budget in the FY 1991/92. The government also contributed Rs. 10 million to the Fund in the following fiscal year. The Fund has a provision to provide wholesale loan to the SCCs and NGOs, who in-turn lend to the rural poor. HMG and the NRB, along with the formal financial institutions, established 5 regional grameen bank replicators, "*Grameen Bikas Banks*", one in each of the five development regions, and also a second tier institution entitled *"Rural Microfinance Development Centre (RMDC)"* during the 1992-98 period. During the same period, two more grameen bank replicators *"Nirdhan and CSD-SBP*" were also initiated in the NGO sector. These two NGOs, later on, promoted *"Nirdhan Utthan Bank*" and *"Swabalamban Bikas Bank*" as microfinance development banks. After the enactment of Cooperative Act, 1992 a total of 228 SCCs were registered by mid-July 1995; 343 SCCs by mid-July 1996; 1,271 SCCs by mid-July 1999; 1,971 SCCs by mid-July 2001 and 2,262 SCCs by mid-July 2002. Of the 1,971 SCCs and 2,262 SCCs that were in operation in FY 2000/01 and 2001/02 respectively, 19 municipality-based SCCs do not belong to MFI category because their lending policies do not match with the MFIs. The financial transactions of such 19 SCCs have not been considered in this paper. Financial Intermediary Societies Act, 1998 has also enabled 37 FI-NGOs to undertake microfinance activities by January 2003.

6. OUTREACH AND CONTRIBUTIONS MADE BY MFIS/PROGRAMS IN POVERTY ALLEVIATION

Information presented in Table 1 above indicates that 38 percent of the population is below the poverty line as in mid-July 2000. Studies have also revealed that majority of the poor live in rural areas and depend heavily on agriculture and agro-based enterprises for their employment and income. In this context, it will be pertinent to review and analyze the contributions made by the formal and semi-formal microfinance institutions/program (MFIs/Ps) towards employment generation and access of formal and semi-formal sector credit to the households below the poverty line.

The MFIS/Ps, which were 13 in 1956 increased to 2,291 [nine microfinance development banks, 2,243 SCCs, including 125 SFCLs but excluding 19 municipality-based SCCs; 37 FI-NGOs, including CSD-SBP and DEPROSC; one SFDP; and one Deprived Sector Credit Program, including IBP, PCRW and MCPW] by mid-January 2003. Their information on outreach, cumulative loan disbursement, repayment, loan outstanding, and deposit mobilization are presented in Table 3 below. Of the 37 FI-NGOs, information of only 15 was available and included in the table. Similarly, information on SCCs (except SFCLs) and SFDP were available only for mid-July 2001. Therefore, *the data presented here would show contributions less than what is actually being made by the formal and semi-formal MFIs/Ps on employment generation and access to microfinance services as of mid-January 2003.*

Credit Disbursements and Outreach

In Table 2 it can be seen that 2,004 MFIs/Ps, combined together, had provided a total of Rs. 20,366 million of microcredit to 716 thousand micro-entrepreneurs by mid-January 2003. Loans were extended in agriculture, micro-enterprises, trade and service sectors. With the projects/activities financed under the institutional loans, the borrowers were able to generate Rs. 3,067 million equivalent of savings. The outstanding loan of the MFIs/Ps with the borrowers stood at Rs. 6,963 million by mid-January 2003. The coverage of the deprived population by the formal and semi-formal MFIs/Ps as in mid-January 2003 has been in the neighborhood of 716 thousand. The normal practice being followed by the MFIs/Ps is "one member, one household". With this practice, the outreach of 716 thousand population may be considered as equivalent to 716 households. Population Census 2001, National Report [CBS 2002] has estimated Nepal's population at 23,151 thousand [male: 11,563,921 and female: 11,587,502] and the number of households 4,253 thousand in 2001. The National Planning Commission [NPC 2001] has, on the basis of the performance of the first three year's of the Ninth Plan, estimated 38 percent of the population below the poverty line. Thus, by assuming 38 percent of the population/households as those below poverty line, the population and the number of households falling below the poverty line is worked out at 8,797 thousand persons [38/100*23151000 = 8797000] and 1,616 thousand households [38/100*4253000 = 1616000] respectively by mid July 2001. *Therefore, it may be said that the formal and semi-formal institutions/programs had, by mid January 2003, provided access of microcredit to 44.31 percent [716/1616*100] of the households below the poverty line.*

Table 2. Credit Operations of MFIs/Ps (As of mid-January 2003)

S. N	Institutions / Programs	Cumulative No. of borrowers (In ' 000)	Cumulative loan disbursement (Rs. million)	Cumulative loan repayment (Rs. million)	Loan outstanding (Rs. million)	Savings collected (Rs. million)
1	**Grameen Bikas Banks: 5 [As of mid Oct. 2002]**	152	**7,529**	**6,243**	**1,286**	**382**
2	**Nirdhan Utthan Bank**	35	**1,184**	**967**	**217**	**65**
3	**Swabalamban Bikas Bank**	27	**1,210**	**1,042**	**168**	**72**
4	**DEPROSC Bikas Bank**	10	**123**	**66**	**57**	**10**
5	**Chhimek Bikas Bank**	3	**55**	**23**	**32**	**5**
6	**Small Farmers Cooperative Limited: Number 125**	69	**1,829**	**849**	**980**	**165**
7	**Savings and Credit Cooperatives*: Number 1851 [As of mid July 2001]**	160	**1,896**	**701**	**1,195**	**2,237**
8	**CSD-SBP (An NGO)**	2	**66**	**54**	**12**	**4**
9	**DEPROSC (An NGO)**	4	**32**	**20**	**12**	**3**
10	**FI-NGOs+: Number 15 [As of mid July 2002]**	12	**58**	**27**	**31**	**-**
11	**SFDP: Number 242 Sub-Project Offices [As of mid July 2001]**	166	**6,384**	**5,344**	**1,040**	**78**
12	**Direct Lending of CBs Under Deprived Sector Credit Program@ [As of mid July 2002]**	76	**NA**	**NA**	**1,933**	**46**
	Total	*716*	***20,366***	***15,336***	***6,963***	***3,067***

Note: NA = Not Available

Sources: (1) Non-Bank Regulation Dept. and Microfinance Dept. NRB .
(2) Small Farmers Dev. Program, At a Glance, ADB/N
(3) Cooperative Department and the Respective MFIs.

This achievement is certainly praiseworthy, but given the need to provide formal microfinance access to all those below poverty line, a lot more efforts are still required. Nearly 56 percent of the poor households are yet to be covered. The achievement of the past falls below the expectations. One reason for low coverage in the past is that the number of MFIs in Nepal was not adequate to cater to the financial needs of the remaining poor households. Second reason is that their service areas were limited, and the third reason is that, though the number of such institutions stood at 2,298, excluding CBs, development banks and finance companies that do not provide microfinance services, in mid-July 2002, majority of them were in the business hardly for 1-2 years. Most were new entrants. So, there

* Does not include the financial transactions of 19 Municipality based SCCs, whose lending policies and programs do not match with MFIs, and of 101 SFCLs operating in mid-July 2001.

+ Does not include the financial transactions of the two NGOs: CSD-SBP and DEPROSC.

@ Includes lending operations under IPB, PCRW and MCPW programs as well.

is a need to (i) identify, initiate, encourage, and assist more and more promoters to register MFIs, and (ii) strengthen the financial and institutional capabilities of the MFIs/Ps presently participating in microfinance market. A study undertaken in Bangladesh (Rahman and Khandker 1994) has also revealed that microcredit programs are highly successful in creating job opportunities and in reducing poverty. This, to some extent, is also true in Nepal. In this context, it is advised that HMG and NRB should (i) emphasize and encourage people in establishing new MFIs, (ii) strengthen the capital base and institutional capabilities of the participants in the microfinance market, and (iii) create enabling environment for MFIs to expand service area, cut down social and service delivery costs, and grow.

Table 3. Priority Sector and Deprived Sector Lending of Commercial Banks

Particulars		Mid-July 2001	Mid-July 2002
Six Months Prior Credit (Rs. million)		96935	104182
Priority Sector			
Required Lending:	**In Percent**	12	9
	In Amount (Rs. Million)	11632	9376
Actual Lending:	In Amount (Rs. million)	13117	16343
	In Percent	13.53	15.69
Excess/Shortfall:	In Amount (Rs. Million)	1485	6967
	In Percent	1.53	6.69
Deprived Sector			
Required Lending:	In Percent	0.25-3.00	2.25
	In Amount (Rs. Million)	2646	2344
Actual Lending:	In Percent	3.6	3.34
	In Amount (Rs. million)[(a)+(b)]	3492	3483
	(a) Direct Lending	1859	1933
	(b) Indirect Lending [(I)+(ii)+(iii)+(iv)]	1633	1550
Banks and RMDC	(i) Share in Grameen Bikas	174	
Banks	(ii) Loans to Grameen Bikas	873	
Cooperatives	(iii) Loans to FI-NGOs and	556	
	(iv) Loans to ADB/N	30	
Excess/Shortfall:	In Amount (Rs. Million)	846	1139
	In Percent		1.09

Note: Required lending rate was lowered by 0.25 percent in both the Priority and Deprived sectors for the Fiscal Year 2001/02.

Source: Bank and Financial Institutions Department, NRB.

Employment Generation

A microenterprise survey conducted in the Uttarganga VDC of Surkhet district [Sharma et al. 1996] revealed that a microenterprise, at start, would on an average generate jobs for 2.10 persons. By sector, the average numbers of jobs created at start varied from a minimum of 1.40 persons in trading[1] to a maximum of 2.40 persons in non-crop agriculture[2]. The average job creation was 3.31 persons in manufacturing[3] and 2.13 persons in services[4]. The survey report also revealed that a microenterprise, at start, would, on an average, require an investment of Rs 14 thousand. This amount includes mostly the fixed capital and also some portion of working capital. The finding that a microenterprise generating employment for 2.10 persons for a loan of Rs. 14 thousand of investment being based on the survey of one VDC can not be generalized for all Nepal. However, in the absence of such surveys conducted in all Nepal basis, the finding stated above may be taken as proxy for all Nepal. With this norm, it may be said that the formal and semi-formal MFIs/Ps have through their microfinance services helped create employment to 1,454,714 poor [Rs. 20,366,000,000/Rs. 14,000 = 1,454,714] by mid-January 2003. This figure does not include the loan amount disbursed by the CBs under the Deprived Sector Credit Program. So, if we add equivalent amount of the outstanding loans of CBs under Deprived Sector Credit Program (Rs. 1,933 million) to the cumulative loan disbursement of Rs.20,366 million, the number of jobs created would increase to 1,592,786 [Rs. 22,299,000,000/Rs. 14,000 = 1,592,786]. *Thus, based on the available statistics it may be said that the formal and semi-formal MFIs / programs had, by mid January 2003, helped create job opportunities to 18.11 percent [1,592,786/8,797,000*100 = 18.11 percent] of the population below the poverty line.*

7. PROBLEMS FACED BY MFIS/PROGRAMS IN ATTAINING FINANCIAL SUSTAINABILITY

MFIs have to be concerned with their financial sustainability because it is a precondition for reaching large numbers of microentrepreneurs with microfinance services over a sustained time period. Financial sustainability refers to a stage attaining which the MFIs become independent of continuing financial resources from governments, international agencies, or charitable organizations. In other words, it refers to the extent, to which a MFI, in addition to being financially viable, mobilizes its own financial resources internally, that is, through equity, deposits, and retained profits instead of depending on government or donor resources.

The first hurdle in reaching financial sustainability is attaining operational self-sufficiency. It refers to the extent, to which a MFI covers its expenses such as salaries and other administrative costs, depreciation of fixed assets, interest on borrowings and deposits (i.e., cost of loanable funds), and provisioning for loan

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[1] Trading in edible oil, fresh vegetables, foreign goods, goat and pig, and paddy.
[2] Vegetable farming, dairy buffalo, fishery, and goat raising.
[3] Liue making, pottery, iron products, cement tiles, carpet weaving, goldsmith, furniture, bamboo products, iron smith, and maadal (typical Nepali musical instrument made out of timber and goat/buffalo/cattle skin) making.
[4] Buffalo cart, tea shop, lodge, retail shop, rice/oil/flour mills, shoe polishing, bicycle repairing, copper utensils repairing, and tailoring

loss (i.e., the cost of loan principal lost to default) out of fees and interest income. According to CGAP, "operational self-sufficiency" requires MFIs to cover all administrative costs and loan losses from operating income. This is calculated by dividing operating income by operating expenses. MFIs that have not yet crossed this hurdle may be said to be heavily subsidy-dependent. Such institutions require frequent injections of fresh funds, and in case such funds are not forthcoming, they will quickly eat-up their capital in financing routine operational costs.

The second hurdle in reaching financial sustainability is financial self-sufficiency. It refers to the extent, to which a MFI (i) covers from its fees and interest income expenses such as interest on borrowings at the market rate, and also the inflation in addition to other costs included in assessing operational self-sufficiency; (ii) has its loan repaid, and (iii) makes a profit for expansion and further growth. According to CGAP, "financial self-sufficiency" requires MFIs to cover all administrative costs, loan losses, and financing costs from operating income, after adjusting for inflation and subsidies and treating all funding as if it had a commercial cost. Once this hurdle is crossed, subsidies in the form of concessional funds are no longer required, and also the inflation does not erode the value of MFI's capital. Theoretically, MFIs must add inflation in the interest rates they charge to their clients. In case, the interest rates are not adjusted for inflation and the return on capital falls below the inflation rate, the MFI would fail to cross the financial self-sufficiency hurdle and the real value of its capital will shrink. Similarly, MFIs that are expanding rapidly also face reduced profitability. Expansion requires investment in staff and facilities that may not be covered from an interest earning loan portfolio for some years. This has the effect of lowering measures of operational self-sufficiency until expansion levels off [Christen et al. 1995]. When an MFI crosses financial self-sufficiency level, the investors can expect a return on equity equivalent to returns that can be obtained elsewhere in the private sector. MFIs that attain this level will be profitable and secured and, therefore, can gain access to commercial funding sources.

In Nepalese context, MFIs that have been involved for more than five years in microfinance services have not yet achieved operational self-sufficiency level. Achieving financial self-sufficiency is still a long way for them. One may ask what could be the reasons for not achieving even the operational self-sufficiency by such institutions/programs?

These institutions/programs have to bear five types of cost: *social cost*, *service delivery cost (including salaries and other administrative costs, and depreciation of fixed assets), fund cost, provisioning for loan loss, and inflation.* Social preparation/activities such as, identification of geographical working area, identification of target group, organization of pre-group training, formation/reorganization of groups, formations of centers have to be performed before a loan is disbursed. Costs incurred on these activities can be categorized as "social costs". Credit and savings services are to be provided in the "Center" which is established in a place convenient to the group members. Field staff visits the center weekly, fortnightly or monthly depending upon the process adopted by the institution. At the center, the field staff performs duties, such as, demand collection, weekly/fortnightly/monthly savings and loan installments collections, loan disbursement, review and discussions on problems and future needs. Costs incurred on the salaries and other facilities provided to such staff and those in the branch/area/regional/head offices along with other administrative costs including depreciation of fixed assets can be categorized as "service delivery costs". Interest paid on borrowed funds and deposits can be categorized as "fund costs". All these five types of costs have to be covered by the fees and interest amount they derive from their loan portfolio.

For the time being, MFIs are getting soft loan from CBs under Deprived Sector Credit Program for on-lending to their clients. Therefore, their fund cost and provisioning for loan loss due to their high recovery rate are not that high. But if the compulsion for CBs to lend in deprived sector, which has to be phased out sooner or later, is withdrawn MFIs will have severe fund problem. MFIs cannot adjust inflation fully in their interest charges for political and social reasons as and when it increases the cost of financing. The operational modality followed by the MFIs/Ps without any doubt is relatively expensive, partly due to the high social cost and partly due to the expensive service delivery system. In case, they do not do effective social preparation and intensive supervision through weekly/ fortnightly/monthly visits, loan quality suffers and, thereby, the non-performing asset increases and provisioning for loan loss will increase.

These are the reasons for MFIs not being able to attain even operational self-sufficiency. Increasing staff productivity, efficiency and loan quality, and curtailing unnecessary staff and thereby administrative cost may reduce the service delivery cost to some extent. Even then, the social cost, which the other formal banking institutions don't incur, and the inflation remain to be managed. One of the ADB's study reports [ADB 2000] has suggested that if the number of microfinance clients is to grow significantly, MFIs need to become financially self-sufficient. That is, they need to be able to cover all administrative costs, loan losses, and financing costs from operating income, after adjusting for inflation and subsidies and treating all funding as if it had a commercial cost. In Nepal it is of national interest to ensure that the MFIs operating in the country attain financial self-sufficiency to be able to provide sustainable microfinance services to a large number of microentrepreneurs. One way to address the problems faced by MFIs/programs, which deal with a large number of small scale loans at the grassroots level, in achieving at least operational self-sufficiency level is to share their social cost and some portion of their costs associated to institutional capacity building, employment generation, technology transfer, and research and development for the initial periods by HMG, donors or institutions who take interest in poverty reduction in Nepal, through grant or soft loan.

Because of the high operational cost, the MFIs/Ps are bound to charge interest on their loans higher than other formal banking sources. It makes high cost loan to the borrowers, so high that they may not always earn that much return from the microenterprise undertaken under such loan. So, there is also a need to ease the interest burden of the borrowers. One option is to subsidize the cost of (i) raw materials (seeds, fertilizers, irrigation, electricity), and (ii) veterinary services, skill development training, and also continue providing livestock insurance premium and capital subsidy on biogas installations to the "hardcore borrowers" by HMG/N. These measures will cut down the borrower's production cost and thereby the interest cost would not be a burden to them, and consequently, the recovery of institutional loan would also increase. High loan recovery rate resulting in low level of provisioning would increase MFI's profit on the one hand, and curtail on borrower's production cost would lead to increased borrower's income on the other. That would be an incentive on the part of borrowers to borrow more from the MFIs and earn more. In such an environment, MFI's loan portfolio and profit both will increase, which will over time lead them towards achieving financial self-sufficiency.

8. ROLE PLAYED BY COMMERCIAL BANKS IN POVERTY ALLEVIATION

Commercial banks have been involved in rural lending since 1974. Even as of today they are required to invest at least 12 percent of their total loan portfolio in "priority sector", and from 0.25 to 3.0 percent in "deprived sector credit". Failure to meet these targets would lead to a penalty equivalent to the highest interest the respective CB charges to its client on the shortfall. However, the CBs are open to choose any one or a combination of the following options to meet the deprived sector credit target.

- Make direct lending to the people below the poverty line.
- Make wholesale loans to ADB/N/FI-NGOs/Grameen Bikas Banks/ licensed SCCs.
- Make share participation in RMDC/Grameen Bikas Banks.

With the exception of a few, all the CBs have been meeting their lending requirements in the priority sector and also in the deprived sector for quite some times. Details of the priority sector and the deprived sector lending of CBs for the last two years are presented in Table 3 below.

Of the deprived sector lending of Rs.3,492 million in mid July 2001 by CBs, the direct lending constitutes 53.23 percent. The corresponding figure for mid July 2002 is 55.50 percent. Seven banks in 2001 and nine banks in 2002 had made direct lending in deprived sector.

The nature of the microcredit services is such that the institutions involved in this sector have to (i) serve a large number of clients with small loan size, (ii) have intensive supervision and follow-ups, and (iii) have highly motivated and rural oriented staff. To venture in such a sector, one would have to bear operational cost much higher than the CBs have to incur in their regular banking activities. For this reason, CBs have been reluctant to lend in microfinance sector. Though, they have been lending in priority and deprived sectors, they have been doing that under compulsion. In reality, they are unwilling partners towards microfinancing. If they were given options, they would choose the second alternative. By the Act under which they are incorporated, they are supposed to be making loans in trade, commerce, export promotion, industries, and other businesses. But, since there was a need for them to be involved in rural financing under social considerations, NRB directed CBs to lend a small portion of their deposit liability in priority sector back in 1974. That was a short of compulsion on the part of NRB also. Now the scenario has changed, many MFIs have entered in formal microfinance market. So, ADB, World Bank and CB's continuous pressure on NRB to withdraw priority sector and deprived sector lending requirements looks a valid demand. However, the recent problem is that, although the number of MFIs stood at 2,298 excluding CBs, development banks and finance companies, their outreach by mid January 2003 was barely 44.31 percent of the households below poverty line. Most of them are new entrants, and even those who have been in the microfinance sector for more than five years, have not been able to expand their network and area coverage to the desired level for various reasons. In fact, there is severe shortage of MFIs and calls for more and more to participate in the sector. *Therefore, it may be advised that till MFIs are sufficient in number and strong enough to provide sustainable microfinance services, the CBs should continue lending in both the priority and deprived sectors.* In the meantime, the government should create an enabling environment through policy and other appropriate supports so that the ones presently participating in the microfinance sector would manage to attain financial viability, and others will find an attraction to participate in the sector.

The present options provided by NRB to CBs either to make direct lending or to go for indirect lending in deprived sector seems quite logical and practical approach. It is true that direct lending in deprived sector is expensive, but CBs who find this option expensive can go for indirect lending. In the past, there were not many MFIs. As a result, CBs did not have much choice but to provide wholesale loans to the same MFI, already loaned by other CBs. Such limitation had created high credit risk to the CBs for placing public deposits on a few MFIs. But as of January 2003, there were already nine microfinance development banks (excluding two second tier microfinance banks), 37 FI-NGOs, 125 SFCLs and 2,118 SCCs (excluding 125 SFCLs and 19 municipality based SCCs). CBs now have ample choice. The immediate need is to establish linkage between the formal banking sector that has the fund but does not want to make direct lending to the poor and the formal microfinance sector that is willing to make loans to the poor but does not have sufficient fund and institutional capabilities. *Therefore, CB's could contribute towards poverty alleviation by providing wholesale loans to those licensed MFIs that are operating at a profit and with good governance. Financing loss-making institutions would be too risky to the CBs.*

Available information indicates that CBs who had made direct lending in the past had good number of branch network. They had branches in urban as well as in rural areas. But due to security problem, most of the rural branches of CBs have now been shifted to district headquarters. With the shrinkage in rural branches, the CBs that had made significant amount of loans through direct lending have, at present, experienced difficulty in doing so. Realizing this fact, NRB had reduced the lending targets in both the priority and the deprived sectors by 25 percent for the fiscal year 2001/02. But such concession cannot be expected for long.

Furthermore, the credit risk is very high in security risk areas. Cease-fire has been agreed upon between both sides and is in force for the last couple of months. But nothing can be said now about the outcome, though all the common people would like to see the lasting peace and security being restored in the country. So given the security situation of the country, CBs should emphasize indirect lending in the deprived sector.

9. DEVELOPMENTAL INITIATIVES TAKEN BY NRB IN SUPPORT OF MICROFINANCE

Agricultural Credit Survey Report [NRB 1972] had estimated total short-term agricultural credit needs and improved technology at Rs. 1,000 million in 1969/70. The credit supplied by ADB/N, the only rural financing institution at the national level, during that fiscal year was Rs. 13.64 million, which was 1.36 percent of the total credit needs of the country. The Report had recommended that NRB should take appropriate steps to improve the access of small sector to formal credit facilities. NBL and RBB's interest was mainly on financing commerce and trade in the urban areas and not in rural lending. There were also a few credit cooperatives and ward/village committees at the grass roots level, but their financial resources and capabilities were limited. Having realized that ADB/N, a few credit cooperatives and ward/ village committees were not in a position to meet the entire rural credit needs, NRB thought of exploring the available alternative window to supplement the existing sources of rural financing. Accordingly, NRB in 1974 directed the two CBs to invest at least 5 percent of their deposit liabilities in the "small sector". This step was the beginning of directed credit system and also involving CBs in rural lending in Nepal. Later on in 1976, the scope of small sector was enlarged so as to cover the whole of agriculture, cottage industries and services and renamed it as "priority sector".

In order to encourage CBs in priority sector lending, NRB took initiatives to establish Credit Guarantee Corporation[5] in 1974 with its major shareholding. This corporation has been providing risk coverage for default or non-repayment of the priority sector loan to the extent of 75 percent of the outstanding loan to the participating CBs. In 1981, NRB introduced Intensive Banking Program (IBP) under which the CBs were required to provide project based loans in priority sector that were to be supervised regularly. Under the program CB's were to extend at least 60 percent of the priority sector loan to rural poor below the poverty line as group based lending without any physical collateral. CBs were also provided with the priority sector-lending manual with details on the requirement of establishing "Priority Sector Credit Department", at the central, regional and branch levels, their staffing and the number of field staff (technical) required, group formation procedures their functions and responsibilities, and project appraisal techniques to

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[5] Now the name of the corporation has been changed to Deposit Insurance and Credit Guarantee Corporation.

make project based loans. Focus on collateral free loan based on the concept of group guarantee helped improve the access of institutional credit to quite a good number of rural poor, who otherwise would have been deprived of the formal credit facilities for the lack of physical collateral.

Realizing that priority sector coverage (256,439 households[6] by mid July 1997) was still lower than expected, NRB introduced "deprived sector credit scheme" in 1990. Under this scheme CBs are required to invest a minimum of 0.25 percent to 3.00 percent of their total loans and advances to the "hardcore poor". Loan of up to Rs. 15,000 extended to the hardcore poor for undertaking priority sector activities was counted under the deprived sector credit. The government had also made provision for providing interest subsidy (33 percent to 80 percent depending upon the size of loan) on deprived sector loans through budgetary allocation [Sharma and Nepal 1997]. Later on, loan amount under deprived sector was extended to Rs. 30,000, and the interest subsidy on such loans was also withdrawn. NRB initiated establishing Grameen bikas banks, one in each development regions with its major shareholding during the 1992 – 1996 period. Grameen bikas banks provide loans under group guarantee system to rural women belonging to "ultra poor" category without any physical collateral. These banks have been following the Grameen Bank Models of Bangladesh. This was yet another initiative taken by NRB towards poverty alleviation.

Realizing that the MFIs operating in the microfinance market had severe shortage of funds for on lending and also needed assistance in enhancing their institutional capabilities, NRB took a lead role in establishing "Rural Microfinance Development Centre (RMDC)" in 1998. Twenty-one banks and financial institutions, including NRB own the share of this second tier institution. RMDC has the provision to provide wholesale loans to MFIs licensed by NRB, for on lending to the sub-borrowers. It can also provide institution-building support to the financial intermediaries in the form of technical assistance, staff training and credit line for the procurement of equipment and service vehicles. However, it seems to be too slow in its operations. It can be substantiated from the fact that it has approved Rs. 299.06 million loans to 19 MFIs, and out of that it has disbursed Rs. 211.45 million to its 18 partners by mid December 2002 [RMDC 2002]. As per the agreement signed between HMG and the ADB on February 21, 1999, HMG shall, out of the loan proceeds of SDR 14,201,000 received under the Loan No. 1650 - NEP (SF), relend to RMDC an amount equivalent to SDR 11,787,000 over a period of six years beginning 1999 under a Subsidiary Loan and Grant Agreement. SDR 11,787,000 is equivalent to about US$ 20,000,000 that at the rate of Rs.78 per dollar converts to Rs. 1560 million. Now, the problem is, RMDC can have access to this fund only up to 2005, and by mid December 2002, that is, in the past three years it has been able to disburse a total loan of Rs.211.45 only. With the present pace will RMDC be able to disburse Rs. 1,348.55 million over the remaining period of three years? Even an ordinary citizen without any background of economics or banking would say "no". The other problem lies in its coverage. Over

[6] Sharma and Nepal 1997.

the past three years, it has approved loans to 19 MFIs, that is, six MFIs per year. As of mid July 2002 (Table 2, column 5), a total of 827 MFIs are involved in microfinance. With the present coverage rate of six MFIs per year it will take 138 years for RMDC to cover the number of MFIs in operation by mid July 2002. These facts clearly indicate that RMDC alone cannot meet the financial need of MFIs in Nepal. Some more institutions are urgently needed. *In this context, NRB needs to come up with appropriate policy measures that would create conducive environment for entry to other second tier institutions. Without a few more second tier institutions with provision of providing wholesale loans to MFIs, it will be impossible to achieve the target of lowering down population below poverty line from 38 percent in 2002 to 30 percent by the end of Tenth Plan Period.*

Developmental role played by NRB in the past is justified on the ground that as a central bank, it had to act that way in those situations where the formal financial market was under developed and the formal microfinance market was almost non-existent. But now the situation has changed. There exists a significant number of MFIs (827 MFIs in mid July 2002) in microfinance market. However, all of them have not yet attained financial self-sufficiency. *So future need is that NRB, rather than continuing such developmental activities concentrates its effort in enhancing their capabilities by undertaking promotional role so that the MFIs are strengthened and are able to provide sustainable microfinance services to the growing number of hardcore poor.*

Promotional Initiatives Taken by NRB in Support of Microfinance

In the past NRB had also undertaken several promotional activities in support of microfinance. The important ones in chronological order are as follows:

Perhaps the first promotional activity undertaken by NRB was its collaboration with the Ministry of Local Development (MLD) in "Production Credit for Rural Women (PCRW)" project and acting as an executing agency for its credit part in 1982. The other far-reaching activity was the adoption and implementation of policy to grant limited banking license to NGOs and SCCs engaged in microfinance in 1990. A study report [Sinha 2000] has expressed this act as a bold step in the promotion of microfinance, and unique in the South Asian region. The paper further mentions that it marked a formal reorganization of the role of alternative institutions in savings and credit promotion to the poor. This, indeed, paved the way for a number of larger NGOs in Nepal to obtain vital experience as financial intermediaries between the formal banking sector and the poor. In the same year 1990, HMG/N established the "Rural Self Reliance Fund (RSRF)", as a pilot scheme, with the objective of providing wholesale loan to financial intermediaries (SCCs and NGOs) that had difficulty in obtaining access to credit for on lending to the rural poor. This fund, administered by NRB, was the first step in Nepal in the direction of exploring alternative means of credit delivery to the poor. The wholesale loan from this source carries an interest rate of eight percent per annum to the intermediaries with the provision of a return of 75 percent on timely payment by the intermediaries to the Fund. With government funding as the only source of loanable fund, RSRF was the first program to recognize and use NGOs as intermediaries for credit delivery to the poor [Sinha 2000].

RSRF stopped lending to the NGOs since 1998/99 for the reason that Financial Intermediary Societies Act, 1998 had not allowed NGOs to accept savings, and RSRF's one of the policies being that of lending a SCC or NGO to the extent of ten times the savings it had collected. Now, the amended version of FISA allows FI-NGOs to collect savings from their group members, therefore, *NRB needs to take initiative to make RSRF funds available to the FI-NGOs as earlier. For RSRF, to continue lending to FI-NGOs does not have to wait for amendment in the Financial Intermediary Society By-laws. It can be done internally with little bit of push from NRB. Such an initiative would improve access of RSRF fund to the FI-NGOs that are not served by RMDC for its strict eligibility criteria.* The other innovative/promotional role played by NRB was its active participation from conceptualization to finalization of Development Bank Act in 1992, under which a total of 21 development banks have been incorporated by mid January 2003, of which 11 are microfinace development banks.

In 1993, NRB adopted a policy of counting CB's wholesale loans to Grameen bikas banks and licensed NGOs and the amount of their (CB's) share participation in Grameen bikas banks as a part of deprived sector credit. This policy provided CBs, with none or a few branch networks, an option to meet deprived sector credit target through indirect way of lending. In 1994, NRB again collaborated with MLD in "Microcredit Project for Women (MCPW)" for channeling ADB funds through NBL, RBB and FI-NGOs to the poor rural women of 12 districts and five municipalities. The most recent and potentially the most far-reaching promotional step undertaken by NRB was its important role in formulating the "Financial Intermediary Societies Act, 1998". This initiative is unparalleled in South Asia with countries like India, Bangladesh, and Sri Lanka lagging behind in terms of progress towards legally empowering NGOs to undertake microfinance activities [Sinha 2000]. However, some of the provisions of the original Act were not appropriate for the growth and financial sustainability of NGOs. Therefore, NRB again proposed, amendments in the problematic sections in 2001. The proposed amendments, was passed by the parliament. However, the by-laws are yet to be amended, without which the amendments in the Act will not be activated. *In this context, NRB now needs to take active roles towards amendments in the by-laws. The amended Act would certainly facilitate and attract potential NGOs to be a participant in microfinance market.*

NRB has undoubtedly made a number of innovative attempts in the past. But, with the increase in the number of poor and low-income households in absolute terms, the demand for microfinance services in terms of both the amount and coverage would also increase in future. NRB therefore, has to prepare itself by enhancing its capabilities to regulate, supervise and monitor large number of MFIs on and above CBs, FCs, and development banks on the one hand, and also come up with innovative and suitable credit policies/regulations that would create an enabling environment for MFIs to grow and attain financial self-sufficiency on the other. Looking at the number of licensed MFIs as of January 2003 and the expected new entrants in the microfinance market, it will be too difficult for NRB to supervise all of them even by increasing its present branch network and man power. Therefore, NRB should think of other alternatives that would take the responsibility of supervising MFIs. This would ease the burden of NRB of supervising increased number of MFIs, and thereby could concentrate on supervising CBs, FCs, and development banks more effectively. It could also carry out other activities, such as, pilot projects, research, data collection and publication, advocacy, and training as suggested by ADB in support of microfinance.

10. ROLE PLAYED BY HMG/N IN SUPPORT OF MICROFINANCE

HMG/N has been playing developmental as well as promotional roles in support of microfinance. Share participations in grameen bikash banks and Sana Kisan Bikas Bank are some of the examples of its developmental activities. But the experiences have shown that private sector managed MFIs are better off than the government owned MFIs. All the government owned MFIs are technically insolvent, because of too much government interferences in their management on the one side, and the respective Employee's Union's interferences in their smooth functioning on the other. A study report [Sharma, et. al., 1996] had rightly stated the extent of government interferences in such MFIs in these words "the party elected to power tries to influence the management by placing some party workers as Chairperson and Executive Director of the bank. The worst thing is that, with the change of government both the Chairpersons and the Executive Directors also get changed. In Nepal, where governments have been changing every six or nine months, the in-stability in the management of RRDBs has become a big issue". The report further expressed its opinion in these words " In Nepal any good programme in the public sector cannot be made free from political interference. The politicians will certainly utilize such programmes for their political benefit. The ethic that the programmes like RRDBs should be run professionally and should not be politicized can not be put into practice in Nepal". Another study [Sharma and Nepal 1997] has stated, "The Employee's Union have also been making unnecessary interference on the smooth functioning of Eastern Rural Development Bank (ERDB). They have been putting pressure on the ERDB's management to favour them on aspects such as new appointments, promotions, posting, training and other opportunities. These activities have been pushing down the public image of ERDB. To some extent this is also true for other RRDBs. If these unions are allowed to function as today, sooner or later it is sure the financial performance of RRDB will cripple down. So there is a need to restructuring and privatizing such institutions.

Initiatives taken in undertaking socio-economic programs like PCRW and MCPW, Third Livestock Development Program (TLDP), Community Groundwater Irrigation Sector Project (CGISP), Microenterprise Development Programme (MEDEP) and Poverty Alleviation Project for Western Tarai

(PAPWT), and initiations in getting FISA and Cooperative Act passed through the parliament are some of the examples of government's promotional activities in the past. These activities have certainly helped MFIs to grow in number. But the problem is that most MFIs are concentrating their activities in the tarai area, and their outreach in the hills is almost negligible. This needs to be addressed without delay. Furthermore, with the substantial growth in the absolute number of poor and low-income households, promotional efforts taken in the past will not be sufficient to cope with the challenges that are to be faced in the future. In the context of poverty alleviation, HMG rather than taking developmental activities, needs to confine itself in promotional roles.

11. SUGGESTIONS

Based on the above discussions, the following suggestions have been recommended for the NRB, commercial banks and HMG/N in the context of poverty alleviation through microfinance:

NRB

- Stop direct involvement in running and managing MFIs.
- Stop owning MFIs and handover presently owned shares of such institutions to the private sector through appropriate and transparent mechanism.
- Innovate other alternatives that would take the responsibility of supervising MFIs.
- Act as facilitator.
- Rather than taking developmental activities, take promotional roles through appropriate policy measures that will create favorable environment for MFIs to (i) enter the microfinance market, (ii) grow, (iii) develop, and (iv) attain the financial viability.
- Take immediate initiative towards amending Financial Intermediary Society By-laws without which the recent amendments made in the Act will not benefit the FI-NGOs.
- Take initiative to make RSRF funds available to the FI-NGOs as earlier.
- Come up with appropriate policy measures that would create conducive environment for entry to other second tier institutions. RMDC alone cannot meet the credit needs of MFIs in future. Its performance over the last three years has clearly indicated that it can neither utilize funds available under ADB Loan No.1650 - NEP (SF) fully over the next three year period, nor, at the present coverage rate of six MFIs per year, is expected to serve the number of MFIs that will be in operation by the end of the Tenth Plan Period. Without a few more second tier institutions with provision of providing wholesale loans to MFIs, it will be impossible to achieve the target of lowering down population below poverty line from 38 percent in 2002 to 30 percent by the end of Tenth Plan Period.

- Continue both the priority and deprived sectors lending policies till MFIs are sufficient in number and strong enough to provide sustainable microfinance services.
- Carry out other promotional activities, such as, pilot projects, research, data collection and publication, advocacy, and training in support of microfinance. However, the extent of NRB's involvement in these activities should be limited to only those on which it has comparative advantage.

Commercial Banks

- Continue lending in both the priority and deprived sectors till MFIs are sufficient in number and strong enough to provide sustainable microfinance services,
- Provide wholesale loans to (i) the microfinance development banks, (ii) the licensed FI-NGOs and SCCs, and (iii) the SCCs with NEFSCUN's membership, which are operating at a profit and with good governance. Financing loss-making institutions would be too risky to the CBs.
- Emphasize indirect lending in the deprived sector till the security/law and order situation in the country improves.

HMG

- Demonstrate firm commitment towards poverty alleviation through action.
- Stop direct involvement in running and managing MFIs.
- Stop owning MFIs and handover presently owned shares of such institutions to the private sector through appropriate and transparent mechanism.
- Stop nominating government staff as Chairperson, Executive Director or the member of the board of MFIs.
- Encourage private sector to establish specialized training institutions for MFI's staff and for the MFI's potential clients.
- The employee's Unions established under the Trade Union Act, 1992 have been making unnecessary interference on the smooth functioning of the formal financial sector including larger MFIs. Therefore, take immediate initiation to amend / clarify the related clauses of the Trade Union Act, 1992, so as to make them applicable only to the workers of industrial establishments.
- Act as facilitator.
- Create favorable policy environment in which more MFIs would be encouraged to work in the hills.
- Develop roads, bridges, communication systems and extension services specially in the hills that will assist MFIs operating in the hills to grow, and the hilly microentrepreneurs to receive technical services and to market their products/services.

- Provide grants or make soft loans available through donor agencies to the MFIs for initial periods to meet expenses on:
  - Social preparation
  - Development of institutional capabilities, MIS system, and human resource.
  - Employment generation
  - Technology transfer, and
  - Research and development.
- Provide subsidy to the small borrowers on:
  - Seed, feed, fertilizers, irrigation, and electricity
  - Veterinary services, and
  - Skill development training expenses
- Continue providing livestock insurance premium, and capital subsidy on bio-gas installations.

ACRONYMS USED

ADB	:	Asian Development Bank, Manila
ADB/N	:	Agricultural Development Bank of Nepal
BFIs	:	Banks and Financial Institutions
CB	:	Commercial Bank
CBS	:	Central Bureau of Statistics
CECI	:	Canadian Centre for International Studies and Cooperation
CGAP	:	Consultative Group to Assist the Poorest
CGISP	:	Community Groundwater Irrigation Sector Project
CSD	:	Centre for Self-Help Development
DFD	:	Development Finance Department
DWD	:	Department of Women Development
ESAP	:	Enhanced Structural Adjustment Program
ESP	:	Economic Stabilization Program
FC	:	Finance Company
FI-NGO	:	Financial Intermediary Non-Governmental Organization
FISA	:	Financial Intermediary Societies Act, 1998
GBR	:	Grameen Bank Replicator
HMG/N	:	His Majesty's Government of Nepal
IBP	:	Intensive Banking Program
LRSC	:	Land Reform Savings Corporation
MCPW	:	Micro Credit Project for Women
MEDEP	:	Micro Enterprise Development Program
MFI	:	Microfinance Institution
MFIs/Ps	:	Microfinance Institutions/Programs
MLD	:	Ministry of Local Development
NBL	:	Nepal Bank Ltd.
NBFIs	:	Non-Bank Financial Institutions
NEFSCUN	:	Nepal Federation of Savings and Credit Cooperative Union

NGO	:	Non-Governmental Organization
NIDC	:	Nepal Industrial Development Corporation
NPA	:	Non-Performing Assets
NPC	:	National Planning Commission
NRB	:	Nepal Rastra Bank
PAGS	:	Poverty Alleviation and Growth Strategy
PAPWT	:	Poverty Alleviation Project for Western Tarai
PCRW	:	Production Credit for Rural Women.
RBB	:	Rastriya Banijya Bank
RMDC	:	Rural Microfinance Development Centre
RRDB	:	Regional Rural Development Bank
RSRF	:	Rural Self-Reliance Fund
SAP	:	Structural Adjustment Program
SCC	:	Savings and Credit Cooperative
SCO	:	Savings and Credit Organization
SFCLs	:	Small Farmers Credit Cooperatives
SFDP	:	Small Farmers Development Project
SHG	:	Self-Help Group
SPO	:	Sub-Project Office
TLDP	:	Third Livestock Development Project
VDC	:	Village Development Committee
WB	:	World Bank

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